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IN THE HIGH COURT OF GUJARAT AT AHMEDABAD

GIFT TAX REFERENCE Nos 1 to 5 of 1997

For Approval and Signature:

HON'BLE MR.JUSTICE M.S.SHAH
and
HON'BLE MR.JUSTICE A.M.KAPADIA

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1. Whether Reporters of Local Papers may be allowed to see the judgements? : NO

2. To be referred to the Reporter or not? : NO

3. Whether Their Lordships wish to see the fair copy of the judgement? : NO

4. Whether this case involves a substantial question of law as to the interpretation of the Constitution of India, 1950 of any Order made thereunder? : NO

5. Whether it is to be circulated to the concerned Magistrate/Magistrates,Judge/Judges,Tribunal/Tribunals? : NO

COMMISSIONER OF GIFT-TAX

Versus

RAMNIKLAL M. BAMBHANIA

Appearance:

1. GIFT TAX REFERENCE No. 1 of 1997

MR MANISH R BHATT for Petitioner No. 1

SERVED BY RPAD - (N) for Respondent No. 1

CORAM : HON'BLE MR.JUSTICE M.S.SHAH
and
HON'BLE MR.JUSTICE A.M.KAPADIA

Date of decision: 21/01/2004

COMMON ORAL JUDGEMENT

(Per : HON'BLE MR.JUSTICE M.S.SHAH)

In these five references, the following common questions of law have been referred for our opinion in

respect of assessment year 1981-82 :-

"(1) Whether the Appellate Tribunal is right in law and on facts in holding that there was no deemed gift when the assessee relinquished his share in the partnership firm in favour of the new incumbent partner ?

(2) Whether the Appellate Tribunal has correctly appreciated the decision of the Hon'ble Supreme Court in the case of CIT vs. Chhotalal Mohanlal, 166 ITR 66 ?"

2. The facts giving rise to these references are as under :-

2.1 All the five assessees were partners in the firm M/s Accurate Engineering Co. having 20% share each. During the previous year relevant to assessment year 1981-82, there was a change in the constitution of the firm in as much Mr GV Modha, Trustee of the Accurate Trust was admitted as a partner with 50% share and therefore reducing the share of all the five assessees by 10% each. Subsequently, there was another change in the constitution of the said firm whereby the assessees partners of the firm retired and the business of the firm was taken over by Mr GV Modha, Trustee of the Accurate Trust as its sole proprietor. The Gift-tax Officer held that all the five assessees are liable to gift-tax on deemed gift arising out of relinquishment of their respective share of 20% in the said partnership firm in favour of Mr GV Modha, Trustee of Accurate Trust without adequate consideration of money or money's worth. He accordingly computed the value of deemed gift by taking average of income for five years from AY 1977-78 to 1981-82 after allowing deduction in respect of interest on partners capital at the rate of 12% by computing the average amount of capital for one year on the basis of interest rates of partners capital for the aforesaid five years and by allowing a further deduction at 20% of profit by way of salary.

2.2 The Deputy Commissioner of Income-tax (Appeals) held that the Accurate Trust has brought in capital of Rs.8,12,602/- while the existing five partners (i.e. the assessees) have withdrawn their capital to the extent of Rs.8,73,954/-. The capital of the new partner M/s Accurate Trust was Rs.8,52,854/-. Hence, the question of deemed gift for relinquishment of their respective shares did not arise. He came to the conclusion that the

capital contributed by the new partner constituted adequate consideration and there was no deemed gift involved. He, therefore, cancelled the gift-tax assessment orders passed by the Gift-tax Officer in all these cases and allowed the appeals of all these assessees.

2.3 Hence, the Gift-tax Officer carried the matter in appeal before the Income-tax Appellate Tribunal. Before the Tribunal, the revenue contended that the goodwill of the business has been held to be an asset by the Hon'ble Supreme Court in CGT vs. Chhotalal Mohanlal, 166 ITR 124 and that, therefore, the capital contributed by M/s Accurate Trust in the capital account cannot be treated as consideration for transfer of goodwill by these five partners in favour of M/s Accurate Trust. The revenue accordingly contended that transfer of goodwill by the five outgoing partners in favour of M/s Accurate Trust was without any consideration and, therefore, liable to gift-tax. The gift was accordingly valued on the principles relating to valuation of goodwill. The Tribunal upheld the finding given by the Deputy Commissioner of Wealth-tax for the following reasons :-

(i) The trustees of M/s Accurate Trust had undertaken to actively look after the business of the firm and they were also liable for losses;

(ii) The contribution of a substantial amount of capital by M/s Accurate Trust will expose the trust to the risk of losses;

(iii) The contribution of capital cannot be regarded as confined to capital account only and not towards goodwill because unless a business has goodwill, no person would like to join that business as a partner and contribute because the goodwill of the firm will attract new capital. Therefore, the capital contribution by the new partners constituted adequate consideration not only in respect of the right to get future profits, but also in respect of the property in the goodwill.

2.4 Since the Tribunal dismissed the appeal of the revenue, the revenue has come in reference.

3. We have heard Mr MR Bhatt, learned standing

counsel for the revenue in all these five references. Though served, none appears for the respondent-assessees.

4. In Commissioner of Gift-tax vs. Punjabhai Kalabhai, (2000) 243 ITR 223, this Court has held that goodwill is an asset of a firm and like any other asset of the firm is capable of being transferred, but at the same time, retirement of a person from a firm and taking accounts at that time does not involve any transfer of property as such. Retirement of a partner and continued existence of the firm carrying on the same business by the remaining partners postulates that the firm carries on the business with the goodwill. It is ultimately a question of contract between the parties as to the settlement of accounts whether the goodwill is to be taken into account or not. For the purpose of inviting operation of gift tax, the first condition is that there must be a transfer from one person to another. As no transfer takes place between the partners or from the firm to the partners or vice verse as a result of dissolution or on retirement of the partner, the taxability of the event is rightly not founded on the basis of transfer of share in the goodwill from the firm to the remaining partners. When the new incumbent has been inducted in the firm for consideration, there is no transfer of future right to share without consideration. Hence, there is no liability to pay gift tax.

5. In the facts of the present case also, both the Deputy Commissioner of Gift-tax as well as the Tribunal have held that M/s Accurate Trust had brought in capital to the tune of Rs.8,52,854/- and the outgoing five partners had withdrawn their capital to the extent of Rs.8,73,954/-. It is thus clear that the new partner had given adequate consideration for being inducted as a partner and the outgoing partners had also received consideration for retiring from the partnership firm. In view of these facts, the Tribunal was right in holding that there was no deemed gift when the five assessees relinquished their share in the partnership firm in favour of the new partner. Since the five assessees received their capital to the aforesaid extent, it cannot be said that the assessees had relinquished their shares in the partnership firm in favour of the new partner without any consideration.

6. As far as the decision in the case of CGT vs. Chhotalal Mohanlal (Supra) is concerned, that was a case where the existing partner brought in his minor sons to the partnership firm without any contribution of capital by the minor sons and, therefore, the Apex Court held it

to be a case of gift.

In the present case, the incoming partner having brought in his own capital, the ratio in Chhotalal Mohanlal's case can never apply.

7. Accordingly, we answer question No.1 in the affirmative i.e. in favour of the assessee and against the revenue.

8. In view of the above discussion, our answer to question No. 2 is also in the affirmative i.e. in favour of the assessee and against the revenue.

9. All these references accordingly stand disposed of.

(M.S. Shah, J.)

(A.M. Kapadia, J.)

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